RESEARCH HIGHLIGHT

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LAND TITLE CONVEYANCE PRACTICES AND FRAUD

PROJECT OBJECTIVES:

- The purpose of this study was to produce a detailed description of title conveyance and mortgage registration, funding, and discharge practices for the province of Quebec and the common law provinces and territories which are using, or in the process of converting to, a land title registry system *(rather than the older deeds registry system still in use in Nova Scotia, Prince Edward Island and Newfoundland and Labrador)*. It also covered the related legislative and regulatory framework, and insurance, recourse and/or compensation schemes related to fraud in title conveyance or mortgage registration, funding or discharge, available to lenders, other parties involved in providing these services and/or to the public.
- This study dealt with two distinct types of fraud.
  - The first type, "fraud on the registry" occurs when documents which are forged or otherwise invalid are registered in the land registry.
  - The second type, "fraud by breach of undertaking," occurs when the lawyer or notary acting for the vendor in a transaction misappropriates the purchase money and fails to apply it to pay off an existing mortgage granted by the vendor.

METHODOLOGY:

The study was based on the following:

- a comprehensive review of relevant literature, legislation, regulations and lawyer's rules of professional conduct to determine the formal law governing the specified types of fraud;
- a comprehensive review of relevant case-law, including formal decisions regarding compensation by the land titles office in Ontario to determine the way in which courts had interpreted the relevant law, and also as a source of evidence of the impact of fraud on victims; and
- interviews that were conducted with provincial officials (in the case of fraud by forgery, primarily) and legal practitioners (in the case of fraud by breach of undertaking, primarily) and title insurance representatives, to determine practice in cases which were settled rather than litigated, and to provide information regarding the overall incidence and consequences of fraud.

MAJOR FINDINGS:

- The harm caused by fraud can be reduced by preventing them or by insuring the loss caused by those frauds which are not prevented. While some steps may be taken to reduce fraud in land conveyancing, complete prevention of fraud would not be cost-effective. The reduction in harm would not justify the increased costs, which would be borne in every transaction, not just those involving fraud. Thus insurance, against the fraud which remains, is crucial to protect victims against loss.
- The compensation provided by land titles systems' assurance funds to those who rely on the registry to their detriment is an important form of insurance against fraud which is not available in jurisdictions with document registration systems such as Québec, Prince Edward Island and Newfoundland and Labrador.
- In addition to the land titles systems' assurance funds, title insurance provides an alternative means of compensation for homeowners and lenders who are harmed by fraud. It is a form of private insurance which protects against many types of loss consequent on a purchase of land, including

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many types of fraud. It is not provided automatically on registration of a property in the land titles system, but must be purchased separately, at the time of the purchase of the land or the interest therein.

- Because title insurance can only be purchased at the time of acquisition of an interest in land, it is not available to homeowners who did not obtain title insurance initially but who might now wish to purchase protection against fraud for their current home. In principle a form of post-purchase fraud protection insurance could be offered, but further study would be required to determine whether it could be sold and administered at a marketable price.

Fraud on the Registry - Introduction

Fraud on the registry can be subdivided into two categories; fraud by forgery and fraud by impersonation. In fraud by forgery the wrongdoer will typically register forged documents transferring the property into his name, then register a forged discharge of any existing mortgage, and finally obtain a new mortgage against the property and vanish with the money without making any payments. Fraud by impersonation most typically occurs in the context of a marital break-up where the spouse with possession of the marital home will have an accomplice impersonate the other spouse in order to sell or mortgage the property without sharing the proceeds with the other spouse.

Prevention of Fraud on the Registry

The most obvious way of preventing fraud on the registry is by verifying the identity of the grantor (vendor/mortgagor) in a land transaction. Requiring the lawyer or notary handling the transaction to require reasonable documentary identification is now a professional responsibility. It is a simple and inexpensive method of verifying identity which is effective against some types of fraud by impersonation, in particular opportunistic fraud practiced by unsophisticated parties.

However, this will not prevent all fraud. Sophisticated wrongdoers may obtain forged identification or they may simply bypass the lawyer or notary and present forged documents, including those attesting to their identity, at the registry office.

More stringent steps to verify the identity of the parties, for example by examination of signatures, is almost certainly not cost-effective given the current state of identification technology, whether at the registry office itself or by the lawyer or notary concerned.

Restricting access to the registry office to lawyers and notaries might prevent a fraudster from directly depositing forged documents. However, even though it is wise to engage a lawyer or notary in any land transaction, prohibiting private citizens from registering documents themselves would be very politically sensitive. Further, it would not prevent fraud by impersonation involving forged identity documents, nor would it prevent fraud in which a lawyer or notary colluded.

It therefore appears that there is at present no cost-effective method of completely preventing the registration of forged documents.

When initial registration of forged documents cannot be prevented, completion of the fraud may be prevented by early detection. In particular, under the Saskatchewan land titles system a notification statement is sent to the registered owner whenever a transfer or mortgage is registered. A complementary provision allows the Director to freeze the register to prevent fraud. Thus when the fraudster registers a forged transfer, the true owner will be notified and may be able to have the register frozen before the wrongdoer is able to mortgage the fraudulently obtained property. *Experience to date in Saskatchewan is limited, but the notification and freeze system appear sound in principle and could provide a significant means of preventing fraud.*

The ultimate means of preventing fraud is deterrence through criminal penalties. Criminal sanctions do provide some deterrence at present, but it is difficult to say whether these penalties should be increased, given competing demands on the criminal justice system.

Compensation in Land Titles Systems for Fraud Victims

In jurisdictions with a land titles system, the land titles assurance fund is an important source of compensation for those harmed by fraud on the registry. There is very significant jurisdictional variation in the land titles compensation systems.

The most complete information on claims against the land titles fund is available from Alberta. The annual average claims paid over the past thirteen years is approximately $31,000. The pattern is that in about half the years there are no claims at all, but every year or two substantial claims are paid. Approximately 400,000 transfers or mortgages are registered annually in the Alberta. This means that the average cost of fraud payouts per transaction is roughly 10¢.

Possession versus Compensation

Fraud on the registry involves a contest between two innocent parties: the original owner of the property, and the innocent party who purchased or lent money in reasonable reliance on the register which showed the fraudster as the owner. Most land titles systems provide that in such a contest, the third party who relied on the register–most often a bank or other institutional lender–is entitled to the property itself, while the original owner is entitled only to compensation. This means that in a land titles system (unlike

a document registration system) it is possible for a homeowner to discover one day that he is no longer the legal owner of the house he lives in, even though he was not negligent or careless in any way. The owner will be entitled to compensation from the land titles assurance fund, and institutional lenders to date have generally been willing to postpone foreclosing on the mortgage until the owner has received compensation which may be applied to discharge the mortgage.

However, delays in receiving compensation are significant in some jurisdictions and the institutional lender will be entitled to foreclose before compensation can be obtained. Further, the compensation from the assurance fund will not normally be perfect, as it does not cover the full legal costs of obtaining compensation, nor does it compensate for mental distress or loss of use of the property as collateral, nor for any sentimental attachment to the property in case the owner is forced to move out.

In New Brunswick, in contrast, it is not possible for a homeowner to have his house sold out from under him, as the land titles system provides that the owner in possession is entitled to the property, while the party relying on the registry is entitled only to compensation. This recognizes that monetary compensation is not usually adequate compensation for loss of a home, while compensation is normally entirely adequate for the third party. In particular, in the most common situation in which the other victim is a bank which lent money on the strength of the register, compensation is probably even better than an entitlement to the property itself, as it will usually be quicker and less expensive for the bank to recover its money by claiming from the land titles assurance fund than by foreclosing on the property. *A land titles system which prefers the owner in possession therefore appears to have substantial advantages and no disadvantages as compared with the standard land titles system.*

Indefeasibility of Title

There is significant variation in land titles system in the treatment of fraud by impersonation. This occurs most commonly in the context of an acrimonious marriage break-up. The party remaining in possession of the house may seek to sell the property without the consent of the spouse by having his or her current partner impersonate the spouse.

In fraud by impersonation, immediate indefeasibility means that the party dealing directly with the fraudster will be protected by the land titles system. Deferred indefeasibility means that a purchaser dealing directly with the fraudster will not be protected by the land titles system, but someone who subsequently takes an interest from that immediate purchaser will be protected.

In systems with "deferred indefeasibility", in particular Ontario and British Columbia, someone who purchases the house in those circumstances will have no defence against the other spouse's claim on the house, and will not be entitled to compensation from the land titles assurance fund. In contrast, systems with "immediate indefeasibility" protect the immediate victim of the fraud.

The argument against "immediately indefeasibility" is twofold. First, the victim was not defrauded because of reliance on the titles registry, which was correct in every respect, but rather because she failed to detect the impersonation. Because there was nothing wrong with the land titles system, it should not be liable for the loss. This argument is not persuasive, since the question is not whether the land titles office was at fault, but rather whether the victim should be insured, regardless of the fault of the land titles office. The second argument is that denying compensation to the immediate victim will reduce the incidence of fraud by giving the victim an incentive to take more care. However, it is really the lawyer or notary for the victim who will take measures to detect the impersonation, not the victim herself. The lawyer or notary who fails to take reasonable steps to verify the identity of the vendor will be liable for professional negligence.

In cases where a lawyer or notary was negligent, the land titles office, which compensates a victim, will have assumed the right to sue the lawyer or notary for the loss caused by their negligence. Thus even the system of immediate indefeasibility does provide incentives for the lawyer or notary to verify the identity of the vendor. Further, the system of deferred indefeasibility denies compensation in all cases, not just those where there were reasonable steps which could have been taken to prevent the fraud. *On the whole, the system of immediate indefeasibility appears to provide better protection at little additional cost as compared with deferred indefeasibility.*

Amount of Compensation

The different land titles systems are uniform in the amount of compensation paid. A victim of fraud who is entitled to compensation will be compensated for the value of the interest in land which has been lost as a result of the fraud, plus the reasonable expenses of bringing the claim. The "reasonable expenses" will not normally cover all of the claimant's actual costs. Additional recovery from the assurance fund of the following amounts, though not currently allowed in any jurisdiction, is sometimes proposed: the entire legal costs of bringing the claim; punitive damages which may have been awarded against the wrongdoer; mental suffering caused by the fraud; and "consequential loss" related to the loss of use of equity in the property, for example business losses resulting from the loss of the opportunity to use the house as collateral for a secured line of credit.

The principle that a successful party is entitled only to reasonable costs and not to their full actual costs is a general principle of Canadian law. This is unfortunate from the perspective of the innocent party, but the rule is needed to provide an incentive to moderate legal fees. This rationale is persuasive, and in any event there is no persuasive argument to suggest that the land titles system should be an exception from the general rule.

Even when fraud occurs, legal costs, mental distress and consequential loss can be reduced or eliminated by ensuring that the procedure for compensation for the lost interest itself is speedy and efficient. *Given the strong arguments against compensation for all of these types of loss, an improved compensation claims procedure is a better approach to these types of harm than is increased compensation.*

Compensation Procedure

Land titles systems can be divided into two categories procedurally. In older systems, such as that in Ontario, the land titles assurance fund is a fund of last resort. This means that the victim of the fraud must first pursue the wrongdoer directly, and it is only once the victim has obtained a judgment against the wrongdoer and has unsuccessfully attempted to collect from the wrongdoer that the victim can turn to the land titles assurance fund. In newer systems, such as those in Saskatchewan and New Brunswick, the land titles system operates as a fund of first resort. A victim of fraud is entitled to claim directly from the land titles assurance fund without first pursuing the wrongdoer. Once payment is made, the Director of land titles assumes the rights of the victim and can themselves pursue the wrongdoer.

The argument in favour of a fund of last resort is that by requiring a judgment against the wrongdoer it ensures that a loss has indeed been suffered. It also minimizes the cost to the land titles assurance fund by ensuring that any available amounts are recovered from the wrongdoer.

A fund of last resort minimizes the costs to the land titles assurance fund, however, it increases the cost of the land titles system as a whole because the consequent delay in compensating the victim results in mental distress and consequential loss which are reduced or eliminated with a fund of first resort.

The argument that the fund of last resort increases incentives to take care is also weak. In the first place, the victim is required to pursue the wrongdoer even in cases where there was absolutely nothing the victim could have done to prevent the fraud. And when something could have been done to prevent the fraud, for example where the fraud was made possible by the negligence of the lawyer for the victim, the Director of land titles will be entitled to pursue an action against the lawyer. *In summary, a fund of first resort appears to be clearly superior to a fund of last resort.*

Fraud by Breach of Undertaking - Introduction

Fraud by breach of undertaking does not rely on aspects of provincial land registration systems. Rather, it exploits features of the procedure by which land is most commonly transferred. Usually, a vendor has a mortgage on the property which he requires the proceeds of sale to discharge, while at the same time the purchaser must finance the purchase by taking out a mortgage on the property. Despite there often being insufficient equity in the property to secure both mortgages, the purchaser's bank advances funds to finance the purchase, and the vendor's lawyer undertakes to use the purchase funds to discharge the mortgage. Fraud by breach of undertaking occurs when the vendor's lawyer breaches this undertaking.

Prevention of Fraud by Breach of Undertaking

The most obvious means of preventing fraud by breach of undertaking would be to implement a practice of cheque splitting. Rather than issuing one cheque in trust from which a vendor's lawyer undertakes to make appropriate payments, the purchaser issues a separate cheque to each party holding an encumbrance on the property. The vendor's lawyer thus has little or no opportunity to deal dishonestly with the funds. While a few procedural details would have to be settled in order to implement a practice of cheque splitting, preventing fraud by breach of undertaking through such a practice would seem to be justified as relatively simple, inexpensive, and effective. *Lawyers in a number of Canadian jurisdictions routinely use split cheques to transfer property and find the practice convenient and efficient.*

Availability of Compensation

Compensation available to parties affected by fraud by breach of undertaking is generally uniform across the provinces. Neither land titles systems nor document registration systems provide any compensation for fraud by breach of undertaking. Each provincial and territorial law society operates a fund with the purpose of compensating those victimized by member lawyers' acts of misappropriation and theft. These funds are of limited efficacy, however, because all are discretionary and many operate as funds of last resort.

While the funds do generally compensate all eligible claimants as a matter of course, this uncertainty of compensation undermines the effectiveness of the funds as compensatory vehicles. Further, where a fund operates as one of last resort, victims of theft must exhaust all possible alternative avenues of compensation before applying to the fund for compensation.

Provincial law societies also have the power to impose special levies on members for the purpose of compensating victims of member lawyers' dishonesty. Compensation through such a levy tends to suffer from the same problems as compensation through law society funds, namely delay and uncertainty.

Operating compensation funds as funds of last resort is not justifiable as a means of providing potential claimants incentive to act carefully to prevent fraud, as there is little a client can reasonably do to prevent his lawyer from vanishing with trust funds. In this respect, lenders are somewhat better situated than clients; nevertheless, they are able to act mainly to detect fraud early rather than to prevent it entirely.

Some victims of fraud by breach of undertaking can obtain compensation through lawyers' professional liability insurance as a first resort. This sort of first resort, nondiscretionary compensation is more timely and more certain than the discretionary, last resort compensation generally offered by law societies. However, not all victims will be eligible to claim compensation from professional liability insurers. Except in Ontario, victims of theft by sole practitioners will not be eligible, as sole practitioners cannot obtain insurance against their own fraudulent acts.

One means of broadening compensation to those affected by fraud by breach of undertaking is to levy a fee on real estate transactions. Such a per transaction fee can then be used, as is the case in Ontario, to purchase additional insurance.

Title Insurance

In additions to the land titles systems' assurance funds, title insurance provides an alternative means of compensation for home owners and lenders who are harmed by fraud. It is a form of private insurance which protects against many types of loss[1] consequent on a purchase of land, including many types of fraud. It is not provided automatically on registration of a property in the land titles system, but must be purchased separately, like any other form of private insurance, at the time of the purchase of the land or the interest therein. Unlike automobile insurance, there is no legal or practical requirement that title insurance be purchased; it is truly optional for either a lender or a home purchaser. Title insurance is available throughout the country, including Québec, but market penetration is reasonably high only in urban Ontario.

After-purchase fraud insurance might in principle be offered as a limited form of title insurance directed against fraud in particular, but more study would be required to determine whether it would be cost-effective to do so.

Title insurance provides very good substantive protection against the types of fraud discussed in this report. Any of the victims of fraud on the registry, whether homeowner or mortgage lender, would have a valid claim under their policy if they had purchased title insurance. In particular, title insurance does provide protection to the immediate victims of fraud by impersonation; that is, it provides "immediate" rather than "deferred" protection. Title insurance also provides protection to an insured purchaser or lender who finds their interest subject to the vendor's prior mortgage in the case of fraud by breach of undertaking.

Title insurance only covers the value of the lost interest in the property. It does not cover punitive damages against the wrongdoer, or claims for mental distress or consequential loss. In this respect the compensation is the same as that provided by a land titles system. Title insurance is also advantageous procedurally. The insured victim has a claim directly against the insurer, without any need to pursue the wrongdoer. In other words, it is a "fund of first resort." Equally important, a claim invokes the insurer's "duty to defend" so all of the victim's legal costs are covered.

The insurer has assumed the claim against the wrongdoer, which it may or may not choose to pursue, but in any event, the victim is not responsible for legal costs. On the whole, the protection provided by title insurance is clearly superior to that provided in older land titles systems with deferred indefeasibility and a fund of last resort, such as that in Ontario. The protection against fraud on the registry is comparable to that provided by the more modern land titles systems, such as those in Saskatchewan and New Brunswick, except that title insurance is broader in also protecting some parties against fraud by breach of undertaking.

A title insurer may dispute coverage, in cases for example where the insurer believes that the victim colluded in the fraud. In that case a claimant may have to sue the insurer to obtain compensation. The same is also true in a land titles system, even one of first resort, as the Director may deny claims he believes are unfounded, in which case the claimant will have to appeal that decision to a court in order to obtain compensation.

Apart from the lack of universality, the only possible disadvantage of title insurance is the cost. Title insurance costs approximately $250 to insure both the owner and lender in a single transaction and $200 if only one party chooses to buy insurance. It is essential to recognize that title insurance provides coverage against many problems other than fraud, and indeed fraud claims are a relatively small proportion of all claims. Thus these amounts cannot be considered to be the cost of protection against fraud alone. *In document registration systems, such as Québec, or in land titles systems with less complete coverage, such as Ontario, title insurance is an attractive option for homeowners and lenders as a means of protection against fraud.*

[1] Title insurance also covers a number of aspects unrelated to fraud. This study discusses only those aspects of title insurance which are related to fraud. Nothing in this study should be taken to suggest that title insurance is or is not desirable or wise for reasons unrelated to fraud.

CONCLUSIONS

The general historical pattern of title fraud is that there are generally few cases, but those cases which do occur cause considerable loss. It is not possible to say whether the recent high profile cases are simply an exaggerated instance of this historical trend, or whether they represent the beginning of a new trend towards more title fraud. This incidence of fraud might increase, if for example, organized crime were to systematically target land registration systems for fraudulent schemes in a way which was not done historically.

With present identification technology it would not be cost-effective at present to prevent such fraud entirely. However, one promising means of preventing fraud involving registration of forged documents, which is not yet widely adopted, is the "notice of registration" system used in Saskatchewan. As well, cheque splitting, which is not yet universally practiced, appears to be a quite effective means of preventing fraud by breach of undertaking.

When fraud is not prevented, compensation for victims is desirable. The land titles systems adopted in Canadian jurisdictions does provide compensation to many victims of fraud on the registry, but there are significant differences in the adequacy of the compensation. Older system, protect a more limited range of victims and impose significant procedural hurdles while newer systems provide more complete protection with a more streamlined process.

In addition, the legal rule, unique to New Brunswick, which ensures that an homeowner cannot be dispossessed of his home, should be considered for wider adoption. In document registration systems, such as Québec, or in land titles systems with less complete coverage, such as Ontario, title insurance is an attractive option.

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